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IN THE

# SUPREME COURT OF THE UNITED STATES

October Term, 1940

NO. 218

RAILROAD COMMISSION OF TEXAS, ET AL.,
Appellants

v.

ROWAN & NICHOLS OIL CO.
Appellee

## REPLY BRIEF FOR APPELLANTS

On Appeal from the United States District Court
for the Western District of Texas

FIRM FOUNDATION—AUSTIN

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## REPLY BRIEF FOR APPELLANTS

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### 1. Alleged Distinctions Between this Case and the First Rowan & Nichols Case

Rowan & Nichols Oil Company attempts to avoid the controlling effect of the decision of this court in the first *Rowan & Nichols* case[1] by making certain alleged distinctions between that case and the case now before the court.

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[1] *Railroad Commission of Texas* v. *Rowan & Nichols Oil Co.*, 310 U. S. 573

The contention that the orders in force at the time of the trial in this case were less favorable to Rowan & Nichols Oil Company than the orders in effect at the time of the trial of the first *Rowan & Nichols* case, has been covered in appellants' original brief, pages 30-33. We will not repeat the argument there made, except to point out that it is undisputed that whereas the total field allowable was increased only 30%, the allowable on the Rowan & Nichols lease was increased about 70%. (R. 206, 207) The amount of proratable oil allocated to this lease increased about 850% (R. 207); and the percentage of the total field allowable allocated to this lease increased about one-third.

The inaccuracy of attempted calculations of reserves was also pointed out in our original brief, at pages 60-61. As we there pointed out, the estimates of the expert for Rowan & Nichols Oil Company increased one billion barrels, or about 50%, over his estimates made at the trial one year previously. (R. 283)

As to the contention that this court completely misconceived the facts in the first *Rowan & Nichols* case (Appellee's brief, pages 16-17) we need only point out that these contentions were repeatedly and ably presented in the petition for rehearing in the first *Rowan & Nichols* case, and were overruled by the court on October 21, 1940.[2]

The alleged undisputed character of the evidence is discussed in the following section of this brief.

[2] 61 Sup. Ct. 66.

## 2. Nature of the Evidence

With respect to the evidence supporting the Railroad Commission's orders as being reasonably necessary to prevent waste and to protect the correlative rights of all owners in the field, we gave a detailed analysis in our original brief, showing, we believe, that the Commission's orders are reasonable and specifically that the appellee has not been and will not be injured by their application. Apparently the appellee feels that by repeating continually that the evidence was "undisputed" (Appellee's brief, pages 18, 19, 20, 24, 39, 46) and that injury to the appellee was "practically admitted," (Appellee's brief, pages 40, 46) it can lead the court to accept its assertions as true. An examination of the record will show that on all material points there were at least serious disputes in the evidence. As to the injury to the appellee we have already shown in our original brief that certainly there has been no actual injury to the appellee up to the present time (Appellants' brief, pages 36-40) and that as nearly as experts can predict, there will be no injury to the appellee in the future. (Appellants' brief, pages 40-44)

The fact that the District Court's findings and conclusions assert that "there really is little or no dispute in the evidence" (R. 548) or that there was "no substantial evidence to sustain the Commission's order" (R. 550) does not make the assertions incontestable. The District Court in this case was obviously attempting to bolster its judgment, as were

the District Court[3] and the Circuit Court of Appeals[4] in making similar assertions in their opinions in the first *Rowan & Nichols* case. This court in that case[5] followed the rule laid down in *South Carolina State Highway Department* v. *Barnwell Brothers, Inc.*, 303 U. S. 177, 191, that the court will examine the record, not to see whether the findings of the court below are supported by evidence, but to ascertain upon the whole record whether it is possible to say that the administrative action is without rational basis. Following the same rule in this case, the court will inevitably be led, we submit, to the conclusion that the orders of the Railroad Commission were erroneously stricken down by the three-judge District Court.

## 3. Property Rights Asserted by the Appellee

Appellee asserts that its current allowable must be substantially in proportion to its reserves as compared with the total reserves in the field. (Appellee's brief, p. 21) And the appellee also makes it plain that it claims that, as a matter of law, it is entitled to produce not merely the amount of oil *originally* in place beneath its leases, but that as each proration order is issued, the Railroad Commission must readjust the allowables to *present or*

[3] See *Rowan & Nichols Oil Co.* v. *Railroad Commission of Texas*, 29 F. Supp. 131, 134, 136.

[4] See *Railroad Commission of Texas* v. *Rowan & Nichols Oil Co.*, 107 F. (2d) 70, 72.

[5] See *Railroad Commission of Texas* v. *Rowan & Nichols Oil Company*, 310 U. S. 573, 581.

*current* oil in place, and thereby give the appellee the benefit of oil drained to it. (Appellee's brief, p. 28)

There is no support in any Texas cases for the appellee's assertions. This court was certainly correct in pointing out in the first *Rowan & Nichols* case[6] that the "rule of capture" is as much a part of the property law of oil and gas in Texas as the rule of ownership in place. This was the explicit holding of the Supreme Court of Texas in *Brown* v. *Humble Oil & Refining Co.*, 126 Tex. 296, 305:

> "Owing to the peculiar characteristics of oil and gas, the foregoing rule of ownership of oil and gas in place should be considered in connection with the law of capture. *This rule gives the right to produce all of the oil and gas that will flow out of the well on one's land; and this is a property right. . . .*" (Our emphasis).

In *Brown* v. *Humble Oil & Refining Company*, supra, the court also points out that *both* the rule of ownership in place and the rule of capture "are subject to regulation under the police power of a state."[8]

The effect of regulation is necessarily to change the measure of the amount of oil which can be produced from a lease. Under unregulated flow, the amount of production would be measured princi-

[6]See *Railroad Commission of Texas* v. *Rowan & Nichols Oil Co.*, 310 U. S. 573, 579.
[8]126 Tex. at p. 305.

pally by the diligence exercised by each operator in drilling and producing wells on his lease as compared with the diligence of surrounding operators. While for certain purposes (such as taxation) the rule of property is the rule of ownership in place, the rule of property for *production* is the rule of capture. The only way of determining how much oil a lease would produce under unregulated flow would be to actually produce it, together with all of the other leases in the field, in this way. Obviously, it would be impossible to carry over to regulated production the same standard of measuring production. It would be wholly impossible to guess how much oil would have been produced under unregulated flow, because it would be purely a matter of speculation as to how many wells would have been drilled on each tract, how fast they would have been produced, and what effect such production would have had on surrounding leases.

The effect of regulation in the East Texas field has unquestionably been to increase the total production from the field. (R. 273, 315) The question, therefore, is as to the proper distribution of oil that would have been produced even under unregulated conditions, and also *oil that would not have been produced at all except for the regulations promulgated and enforced by the Railroad Commission.*

The Texas courts have never laid down hard and fast rules for the allocation of production under regulated flow. The farthest that any Texas court has gone is the statement made by the Su-

preme Court in *Brown* v. *Humble Oil & Refining Co.*, 126 Tex. 296, 312, that the Railroad Commission should adjust the allowables so as to give the owner of a small tract "only his just proportion of the oil and gas" and that, "By this method, each person will be entitled to recover a quantity of oil and gas substantially equivalent in amount to the recoverable oil and gas under his land."

After the foregoing opinion was announced by the Supreme Court of Texas on June 12, 1935, the Railroad Commission by recitals in its order of August 26, 1935, (Defendants' Exhibit No. 16, offered R. 434, copied R. 516) found that the assumptions which were made by the Supreme Court in its opinion were contrary to the evidence of experts at numerous hearings before the Railroad Commission.

Thereafter, on November 27, 1935, the Supreme Court of Texas, on motion for rehearing, repudiated the suggestions that it had undertaken to prescribe "rules and standards by which to determine property rights and as standards to control the Railroad Commission in promulgating conservation rules and orders relating to oil and gas." (126 Tex. at p. 315) Specifically, it repudiated the suggestion that proration based on acreage was required. It recognized that there are many "factors, facts and circumstances" that must be considered in each case, that "all questions of fact are primarily for the Commission to determine" and that its orders will not be set aside "unless they

are clearly illegal, unreasonable or arbitrary." (126 Tex. at p. 316)

The only other expression in the Texas courts is the recent statement in *Gulf Land Co.* v. *Atlantic Refining Co.*, 134 Tex. 59, 71:

> "It is the law that every owner or lessee of land is entitled to recover the oil and gas in or under his land, or their equivalents in kind."

Nothing in the foregoing decisions indicates that the Railroad Commission must adjust the allowable to be in proportion to current reserves under a lease. It is obvious of course that such a system would be extremely favorable to operators like the appellee whose lease is situated in the eastern portion of the fairway and whose lease, after nine years' production, still has as much oil under it as when the field was first opened. If the appellee and other operators similarly situated can produce currently in proportion to their reserves and also much longer than leases in less favored portions of the field, they obviously will produce much more than their oil in place (R. 270, 327-328, 373) and therefore much more than they are entitled to produce under any Texas decision.

Since appellee's leases have not been actually depleted at all up to this time (Appellants' brief, pages 36-39), since they will ultimately recover at least the equivalent of the oil originally in place beneath such leases (Appellants' brief, pages 40-

44), the Railroad Commission has adopted a reasonable method of allocation—one certainly not in conflict with any Texas rule of property. Of course, the Railroad Commission retains the power of continuous supervision for relief of any inequalities or injustices that may arise in the future.

## 4. Extent of Judicial Review under Texas Statutes According to Texas Decisions

The appellee in its brief (pages 53-58) asserts that the test of whether an order is reasonable under the Texas statute is different from the test of whether it is confiscatory and discriminatory, in violation of the Fourteenth Amendment, and that the burden on the party attacking such an order is apparently no more than that which exists in an ordinary suit between private persons.

Even if it were true (which we deny) that a different test would be applied under the Texas statutes by the Texas courts in determining whether the order is valid, this court has held that it will go no further in passing upon the validity of the order under the Texas statutes than it would go in determining its validity under the Fourteenth Amendment. In the amendment to its opinion filed on October 21, 1940, this court said:[9]

> "While the presence of a federal question may also open up state issues, *Siler* v. *Louisville & N. R. R.*, 213 U. S. 175, the claim here founded on Texas law is derived from a statute

[9] 61 S. Ct. 66

requiring proration on a 'reasonable basis.' Vernon's Texas Annotated Civil Statutes (1925) Art. 6049c, § 7. The Texas decisions, in so far as they have been brought to our attention, do not make clear whether the local courts may exercise an independent judgment on what is 'reasonable.' Compare *Brown* v. *Humble Oil & Refining Co.*, 126 Tex. 296, 316. But, in any event, as we read the Texas cases, the standard of 'reasonable basis' under the statute opens up the same range of inquiry as the respondent in effect asserted to exist in his claims under the Due Process Clause. These latter claims we have found untenable. *What ought not to be done by the federal courts when the Due Process Clause is invoked ought not to be attempted by these courts under the guise of enforcing a state statute.* Whether the respondent may still have a remedy in the state courts is for the Texas courts to determine, and is not foreclosed by the denial, on the grounds we have indicated, of the extraordinary relief of an injunction in the federal courts." (Our emphasis)

It is quite evident that the appellee is trying to induce this court to attempt to do under the guise of enforcing a state statute what it has held that it will not do when the Due Process Clause is invoked. This court has expressly held in the *Rowan & Nichols* case, quoted above, that it will not allow the federal courts to be used for this purpose.

However, we believe that a reading of the Texas cases makes it plain that an attack upon an order of the Railroad Commission is not an ordinary civil

case, and that the burden upon the plaintiff is to show in effect that there is no substantial evidence affording a rational basis for the Railroad Commission's order.

The Texas statute allowing appeals from orders of the Railroad Commission in oil and gas cases, Article 6049c, Section 8, provides:

> "Any interested person affected by the conservation laws of this State relating to crude petroleum oil or natural gas, and the waste thereof, including this Act, or by any rule, regulation or order made or promulgated by the Commission thereunder, and who may be dissatisfied therewith, shall have the right to file a suit in a Court of competent jurisdiction in Travis County, Texas, and not elsewhere, against the Commission, or the members thereof, as defendants, to test the validity of said laws, rules, regulations or orders. Such suit shall be advanced for trial and be determined as expeditiously as possible and no postponement thereof or continuance shall be granted except for reasons deemed imperative by the Court. In all such trials, the burden of proof shall be upon the party complaining of such laws, rule, regulation or order; and such laws, rule, regulation or order so complained of shall be deemed prima facie valid."

This statute applies to appeals from all orders of the Railroad Commission relating to oil and gas, no distinction being made between orders granting drilling permits, proration orders, or any other kind of order relating to oil and gas.

The leading case applying to appeals to the courts from oil and gas orders of the Railroad Commission is *Gulf Land Co.* v. *Atlantic Refining Co.*, 134 Tex. 59, 131 S. W. (2d) 73 (1939) containing a very careful analysis of the law by Judge Critz of the Supreme Court. After quoting from Article 6049c, Section 8, Revised Civil Statutes, Judge Critz says:

(134 Tex. at pages 73, 74)

"As already noted, our oil and gas conservation statutes provide an appeal from the Commission to the District Court of Travis County, Texas. The action before us here is such an appeal. In ordinary civil actions the district court, or any other trial court, exercises original jurisdiction to find and determine all fact questions, as well as all law questions. *The action provided by statute for an appeal to a district court of Travis County to review the rules and orders of the Commission is clearly not an ordinary civil action.* To the contrary, it is a special statutory action to enforce a right which exists only by statute, and not under the Constitution or at common law. Alpha Petroleum Co. v. Terrell, 122 Texas 257, 59 S. W. (2d) 364 Id. 372. It is the undoubted intention of the statutes under discussion to clothe the district court with all of its constitutional and statutory jurisdiction in passing on all questions of law which arise in the appeal from the Commission to such court. We encounter no difficulty in reading this conclusion. The duty of defining the jurisdiction of the court to hear and determine fact questions under our oil and gas conservation statutes has given us very grave concern.

"...

"As already indicated, we hold that the appeal provided by Section 8 of Article 6049c, supra, contemplates that the district court shall exercise its general jurisdiction in determining or deciding all questions of law arising under such action. *We think, however, that, generally speaking, the law contemplates that the Commission shall be left free to finally determine controverted issues of fact. . . .*

" . . . To our minds, the law contemplates that the fact findings made by the Commission in passing upon such applications are subject to review and correction by the courts only to the limited extent hereinafter stated. The court, on appeal from the Commission's order, should not set aside an order of the Commission either granting or refusing to grant a well permit unless such order is illegal, unreasonable, or arbitrary. *In so far as the fact findings upon which the order is based are concerned, the order is not illegal, unreasonable, or arbitrary if it is reasonably supported by substantial evidence.* Stated in another way, *the court does not act as an administrative body to determine whether or not it would have reached the same fact conclusion that the Commission reached, but will consider only whether the action of the Commission in its determination of the facts is reasonably supported by substantial evidence.* 34 Tex. Jur., p. 712, Sec. 11, and authorities there cited. To permit the court to substitute its fact findings on controverted issues of fact in such instances would add nothing of value to the administration of the law or the rule under discussion, but, to the contrary, would destroy all

uniformity of Commission administration thereunder. . . . " (Our emphasis)

The decision of the Supreme Court of Texas in the *Gulf Land Company* case *supra*, is in line with what was said by the same court in *Brown* v. *Humble Oil & Refining Company*, 126 Tex. 296, 83 S. W. (2) 935, 87 S. W. (2d) 1069.

(126 Tex. at page 316)

" . . . All questions of fact are primarily for the Commission to determine.

" . . . The duty is lodged with the Railroad Commission to make rules to carry out the mandates of the Legislature, and to impartially enforce them. In the exercise of its power to grant exceptions to its rules, it is the duty of the Commission to treat all interested parties justly, fairly, and impartially under all the facts and circumstances of the case; and the actions and rulings of the Commission in attempting to accomplish such rules will not be disturbed by the courts, unless they are *clearly illegal, unreasonable, or arbitrary.* All rules and rulings of the Railroad Commission are presumed to be valid until the contrary is made to appear. . . . " (Our emphasis)

It is noteworthy that both of the foregoing cases were decided by the Supreme Court after the decisions under the railroad rate statute cited by the appellee. In view of this fact, it is extremely doubtful if these cases would now be followed, even in railroad rate cases. At any rate, it is perfectly clear from

the more recent decisions of the Supreme Court of Texas that appeals from orders of the Railroad Commission in oil and gas cases are not ordinary civil cases, and that orders of the Railroad Commission in such cases will not be set aside where there is substantial evidence to support them.

A still more recent decision sustaining the same view is *Humble Oil & Refining Co.* v. *Turnbow*, 133 S. W. (2d) 191 (Tex. Civ. App.). In this case, the District Court sustained the order of the Railroad Commission where the record of the hearing before the Railroad Commission showed that it acted upon substantial evidence. Judgment was granted at the close of the plaintiff's evidence, although no testimony was offered except the record of the Railroad Commission's hearing and expert testimony contradicting the evidence heard by the Commission. The Court of Civil Appeals affirmed the judgment of the trial court and the Supreme Court of Texas on January 3, 1940, approved the opinion and judgment of the Court of Civil Appeals by refusing application for writ of error. Humble Oil and Refining Company then filed with this court a petition for certiorari, *mainly on the ground that it had been denied an independent determination of the facts by the Texas courts* and therefore had been denied due process under the Fourteenth Amendment. This court denied petition for certiorari on October 14, 1940. *Humble Oil & Refining Co.* v. *Turnbow*, 61 S. Ct. 10.

The settled Texas law is correctly stated by Judge

Hutcheson in *Gulf Land Co.* v. *Atlantic Refining Co.*, 113 F. (2d) 902, 904 (5th Cir., 1940) as follows:

> " . . . Under the settled law of Texas as carefully laid down in Gulf Land Co. v. Atlantic Refining Co., 134 Tex. 59, 131 S. W. (2d) 73, and in later cases citing it, it is beyond question that the commission is primarily charged with the duty of, and vested with a wide discretion in, determining whether a permit should be granted. *It is equally beyond question that in the special statutory action, to set the order aside, provided by Article 6049c, unless it appears that its finding and order is unsupported by substantial evidence, the order must stand.* For the court may not substitute its judgment or opinion for that of the commission. . . . " (Our emphasis)[10]

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[10]Under similar statutes, the Texas courts have laid down substantially the same rule in the following instances:

*Permits under Motor Carrier Laws:*

*Shupee* v. *Railroad Commission of Texas*, 123 Tex. 521, 73 S. W. (2d) 505:

(73 S. W. (2d) at page 508)

"We think it clear that the intention of the statutory provisions is that the decisions of the Railroad Commission upon the granting or refusing of any permit to operate a bus line over any highways in Texas shall be final and conclusive, unless it acted unreasonably and unlawfully, or unless its decisions had no basis in fact and were arbitrary or capricious. *In other words, if the findings and orders of the Railroad Commission in such matters had any reasonable basis in fact, and were not shown to be arbitrary and unreasonable, they must be supported by the court.* The court cannot substitute its judgment for that of the commission, unless it be shown that said judgment of the commission was without foundation in fact, or was unreasonable or arbitrary. . . . " (Our emphasis)

*Rate Orders for Gas Utilities:*

*United Gas Public Service Co.* v. *State*, 89 S. W. (2d) 1094, 1102 (Tex. Civ. App.) 303 U. S. 123:

" . . . That the complaining party attacking a rate as being unreasonable and unjust must allege facts which, if proved,

## CONCLUSION

For the reasons stated, it is respectfully prayed that the judgment of the three-judge District Court be reversed.

Respectfully submitted,

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would show the rate to be unjust and unreasonable as a matter of law, and to prove by clear and satisfactory evidence *'which leaves no reasonable doubt in the judicial mind that the rate or rule is unjust and unreasonable.'* R. R. Comm. v. Galveston Chamber of Commerce, 105 Tex. 101, 145 S. W. 573, 580; R. R. Comm. v. Weld & Neville, 96 Tex. 394, 409, 73 S. W. 529." (Our emphasis)

The opinion of the Court of Civil Appeals was approved by the Supreme Court of Texas, which refused writ of error. This court on appeal affirmed the judgment of the Court of Civil Appeals. *United Gas Public Service Co.* v. *Texas*, 303 U. S. 123.

*Permits under Liquor Laws:*

*Texas Liquor Control Board* v. *Lanza*, 129 S. W. (2d) 1153, 1154 (Tex. Civ. App.; application for writ of error dismissed by Texas Supreme Court with notation, "Correct Judgment.")

" . . . The settled rule, stated conversely, is that, orders or findings of fact of a regulatory body or commission, are not reviewable on appeal unless they are unsupported by evidence; Humble Oil & Refining Co. v. Railroad Commission, et al., Tex. Civ. App., 112 S. W. (2d) 222. . . . "

## ACKNOWLEDGMENT OF SERVICE OF REPLY BRIEF

Service of the foregoing reply brief is acknowledged this 10th day of December 1940.

Attorney for Appellee,
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